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## Ukraine

**Post:** Kiev

### Long Term Perspective of Poultry and Livestock Production

**Report Categories:**

Poultry and Products

Livestock and Products

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**Report Highlights:**

This voluntary report reviews historical factors that influence production and trade in poultry and red meat. It finds that a current trend in Ukraine's poultry and swine industries, positive growth potential, is being realized and can pose a significant competitive threat to U.S. exports to Ukraine and to the region. These competitive advantages follow from the vertical integration of Ukrainian producers. In contrast, this report finds no signs of future competition to the U.S. beef industry despite growth in Ukraine's dairy sector, which is closely linked to domestic beef output.

## **General Information:**

***Data included in this report is not official USDA Data unless stated otherwise. Official USDA data is available at <http://www.fas.usda.gov/psd>***

## **Executive Summary**

A typical GAIN report provides three years of production and trade overview. Although beneficial, this type of reporting does not show the broader picture, which would help explain historical production and consumption factors, and allow for a better understanding of trends. Accuracy of such longer term forecasts may be not as good as annual ones, but they would allow an evaluation of Ukraine's position in the meat market in the long run.

Our recent annual reports suggest that Ukraine had reached relatively stable consumption levels of meat, while production is expected to rise. This report evaluates Ukraine's perspectives in production of poultry, pork and beef products for the next five years. Development of industry associations and increased transparency of public agricultural companies in recent years made this voluntary study possible. Several market factors may influence production in the future, but many companies have specific expansion projects that allow for rather precise forecast in the next 4-7 years. The forecasts are better the fewer companies are in the sector and more transparent they are, and thus the most precise production forecast can be made for the poultry industry. Ukraine's pork industry is much more dispersed and less data is available. Beef production in Ukraine is a byproduct of the dairy industry and forecast precision is probably not as good.

The results of the study suggests that Ukraine will become a regional exporter of poultry and (to lesser extent) of pork in the near future. Import of these products from the U.S. and the rest of the world will decrease significantly while Ukraine's exports will grow. Ukraine will establish itself as regional competitor to the U.S. in Former Soviet Union countries and possibly the Middle East. However occasional market opportunities in Ukraine will be available. Ukraine had also stabilized beef production, but there are no signs that it will become a major exporter of beef in the next five years.

## **Ukrainian Poultry Market Matured**

Poultry producers that started significant production expansion in the early 2000's were able to satisfy domestic demand for poultry by 2009. The financial crisis also played a role limiting disposable incomes, but consumption of poultry did not increase when incomes rebounded in 2010/11. In the following years, Ukrainian poultry producers took a break, concentrating on optimization of the existing facilities and investing into production risk mitigation through vertical integration. Owning feed mills, common for the big production farms, quickly expanded into land, machinery, distribution centers, logistics, and even retail chains. These additional investments in auxiliary businesses resulted in a relatively slow 5-10 percent poultry production growth.

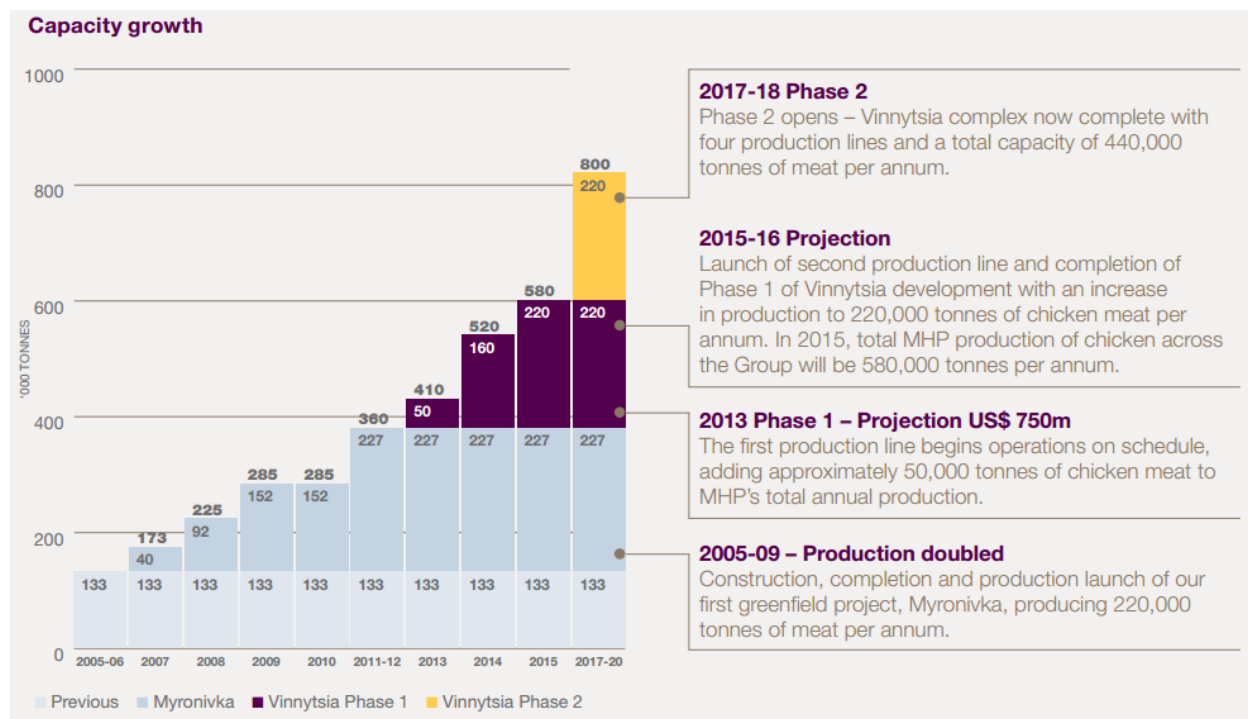
Concentration in the industry increased dramatically with the top four companies responsible for almost 75 percent of the industrial poultry production in the country with the largest one, MHP, responsible for over 50 percent of production. Due to the rather limited number of industry players and public nature of many of them poultry production forecast can be good. Similarly to annual reports, a long-term forecast can be built on company-by-company basis.

***Myronivsky Hliboproduct LLC*** (commonly known as MHP) became a public company in 2008

through the placement of the Global Depository Receipts (GDRs) at London Stock Exchange (LSE). Currently MHP intensively invests in its core business – poultry production and processing through massive investments into new production facilities situated in Central Ukraine (Vinnytsia Production Facility). At the same time it is continuing investments into vertical integration (tripling crop area since 2008), processing, and marketing. It also works in the fruit business, poultry semi-processed products, goose meat, foie gras, and beef production. This company has never attempted to enter the pork production business despite significant domestic demand and insufficient domestic production. The focus of MPH was always on poultry and related areas.

According to the Company's expansion plans, the production capacity will be more than doubled by 2017-20. Expansion will be made through 110,000 ton production phases which will somewhat decrease the risks on foreign markets. By now the first phase of the new production facility is running in the test mode. MHP plans to have the facility fully operational in 2015. Expansion scale is immense as the biggest producer in Ukraine is building the biggest one-site poultry facility in Europe. Output will spill into neighboring markets in Russia, former Soviet Union countries, Middle East, and even the EU. Limited access to EU market could be reached through the 40 TMT TRQ only after empowerment of the Free Trade Agreement (FTA) between the EU and Ukraine. Immediate supplies in the next year or two are possible, but they are likely to be aimed at establishing Ukrainian poultry products in the EU rather than on profit generation.

### Myronivsky Hliboproduct Expansion Plans



Source: Myronivsky Hliboproduct Annual Report 2011; Part 1. Corporate Overview 2011

The second largest Ukrainian poultry producer, *Complex Agromars*, is a privately owned company; thus information on it is rather limited. However, similarly to MHP there are public statements made by management on future expansion plans. Agromars plans to increase poultry production to 300,000 tons, reaching MHP's current scale. Similarly to MHP, the company is actively investing into vertical integration. As of today Agromars does not massively invest into big poultry semi-prepared production facilities limiting output to existing demand.

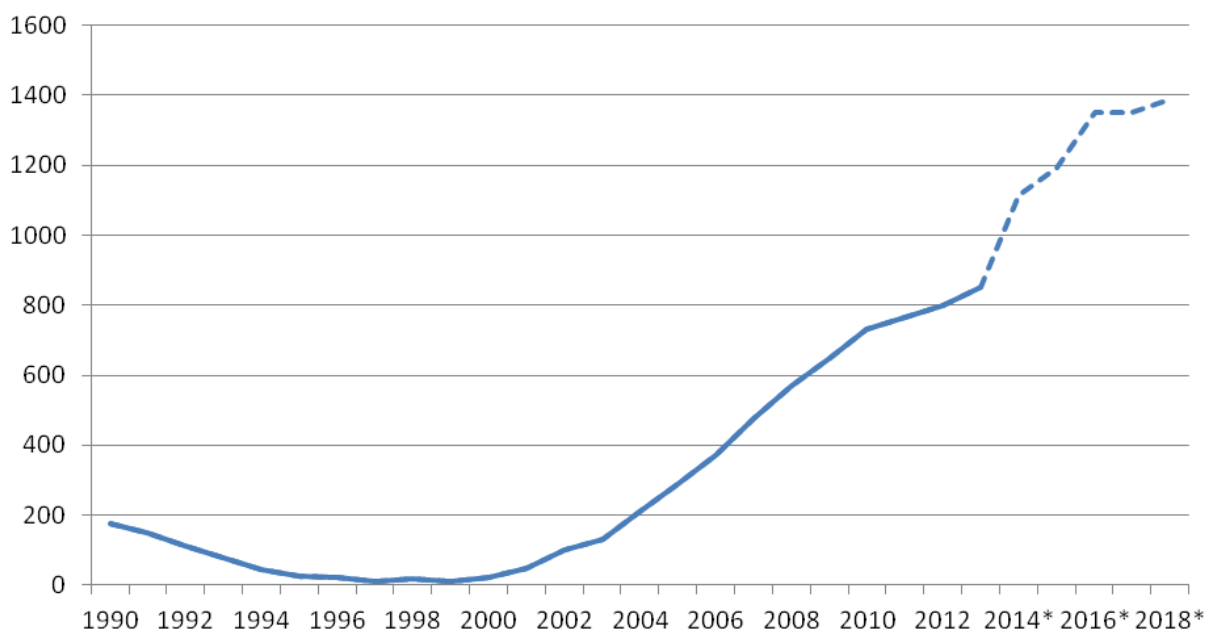
Activity of smaller producers: Ptahocombinat Dniprovsky, Agro-Oven Corp., Volodymyr-Volynsk Ptahofabryka and others will remain to be limited to regions where their production is located. Some bigger producers in this group will be rather flexible due recent investments into production facilities. Similarly to bigger companies, these producers invest into crops and combined feed production to benefit from vertical integration. Pressure on mid-sized and small producers is expected to increase as bigger producers expand.

Agro-Oven Corp (4<sup>th</sup> largest poultry producer) is an interesting example of a second line company. Although smaller than the companies noted above, it remains in the regional market. At the same time management expanded into high quality pork production. Increased demand for pork was covered mostly by imports.

Along with investments into crops (it operates on 20,000 hectares) and poultry it invested into pig production, with the project being done over ten years. Now this Corporation occupies the 10<sup>th</sup> position in the rating of Ukrainians pork producers with over 3,900 sows in 2011 (approximately 75,000 feeder pigs).

Combined production plans of the major market players as well as insignificant increases expected in the midsize producer's division suggest the following production expansion path.

### Ukraine's Poultry Production, 1000 MT



Source: Official USDA data for 1990-2012; FAS-Kiev own calculations for 2014-2018.

\*Forecast

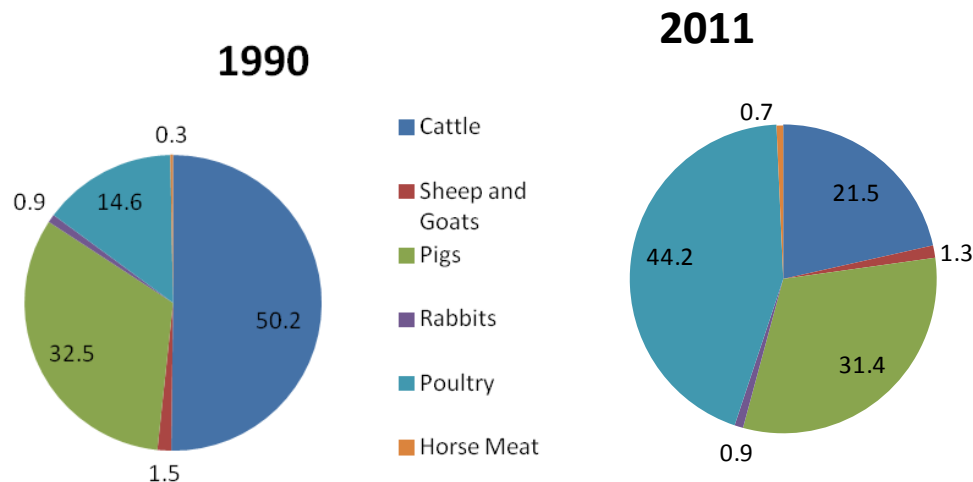
As explained above, the production stabilization plateau (2010-2012) was achieved after satisfaction of domestic demand and start of the expensive renovation programs. These programs should bring a significant production increase in 2013-2016 with some stabilization in 2017-18. The 4-5 year forecasts are more difficult due to increased uncertainties.

Growth perspectives will continue to be dependent on availability of new markets for Ukrainian poultry. So far the industry was reliant almost exclusively on domestic consumers who continued to increase poultry consumption due to shortage of disposable incomes or other arguments (healthier white meat, ease of cooking etc.) Further consumption growth can be caused by the income growth, although recent numbers do not confirm this hypothesis; for example, disposable incomes were growing in 2010-2013, but poultry imports in these years grew insignificantly.

*Source: Official USDA data*

This suggests insignificant domestic market growth potential. Further income growth may also result in increased popularity of other proteins (mainly pork). In its recent history, the poultry industry had no competition with other proteins. Poultry consumption was constantly growing in 2000-2008. Now poultry producers may face a competitive threat from other proteins as consumers return to old consumption pattern.

### Ukraine's Animal and Poultry Production Structure

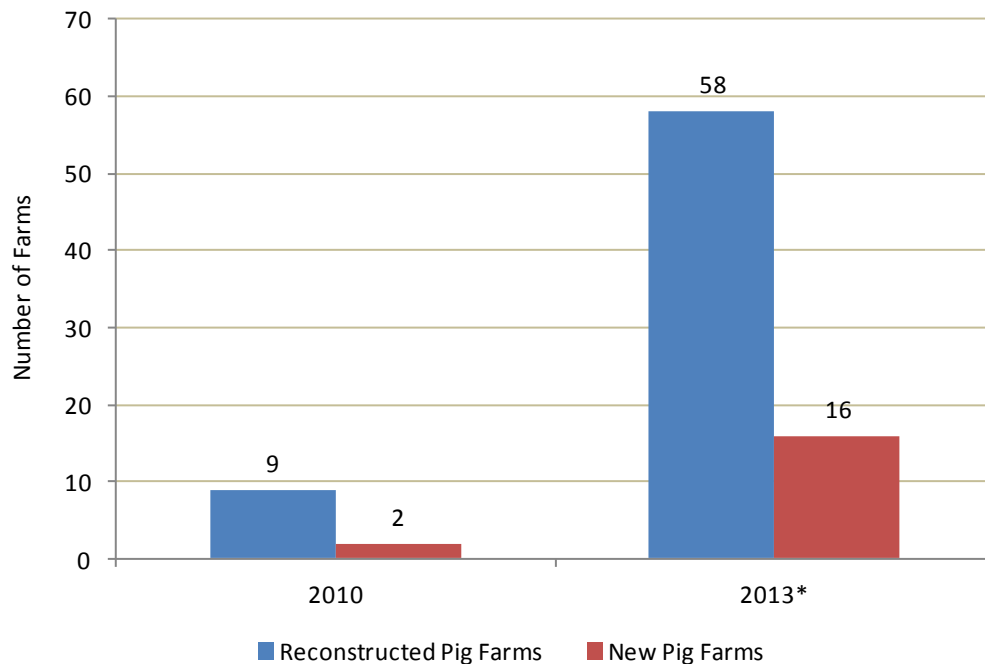


*Source: Agriculture of Ukraine Yearbook, State Statics Service of Ukraine*

### Ukrainian Pork Producers are Planning for Massive Expansion

According to public information available from various sources Ukrainians pork industry is in the threshold of significant production expansion. This rapid production growth will take place in both upgrading existing production facilities and new farms. The new facilities are planned all over the country: the biggest landowner and egg producer UkrLandFarming (530,000 hectares of land, three percent of the Ukraine's grain crop) announced about \$1 billion investment into construction of the pig farms and meatpacking plant in southern Ukraine. Danosha LLC (controlled by EU based Axzon Group) is negotiating a \$54 million loan from the International Finance Corporation (IFC) of the World Bank for two new production facilities in Western Ukraine. KSG Agro is about to make a similar \$50 million investment into major renovation of its pig farm in Central Ukraine. Ukraine's second largest land owner (422,000 hectares) and the largest oilseeds crusher, Kernel Group, announced about new facility construction in Central Ukraine with plans to expand further in the future.

### Construction and Renovation of Ukrainian Pig Farms



Source: Ministry of Agricultural Policy and Food

\*Forecast

From a return on investment standpoint, pork production is less attractive than poultry due to a longer pig growth cycle and more expensive meat. In a low middle income country, consumers prefer less expensive protein (poultry) even if there are traditional preferences to red meat products (pork and beef). Investments in pork production are growing primarily due to lack of business opportunities in poultry where four major producers control almost three quarters of the market. The entry ticket price into this industry is high and may not be paid back as new comers will have to fight for the domestic market share or rely on unstable and highly regulated export markets elsewhere. Investments in pork production look riskier and return period looks much longer.

The five year forecast provided below is built exclusively on publicly made investment statement of Ukrainian industrial pork producers. Some of them are mentioned in this section above. Some projects may be delayed or even canceled, but the overall production trend suggests over one-third production increase by 2018.

## Pork Production (1000 MT)



Source: FAS/Kyiv own estimates

### Reasons for Production Expansion

There are multiple reasons for a pig production boom in the near future. Large Ukrainian agricultural groups working on hundreds of thousands of hectares of land collected significant cash resources from operations with crops and oilseeds. Many of them exhausted growth options in crops and consider business diversification and expansion into riskier, but potentially more lucrative businesses. Many consider crop production margins insignificant and would like to benefit from value added by converting of their grains into meat. Many oil crushers are looking for ways to utilize meal and benefit from vertical integration. Vertical integration has proven to be a major competitive advantage in poultry and swine business. Producers can significantly reduce input price and weather risks, benefiting from the economy of scale and keeping costs at very low level. Vertical integration results in average farm size growth. The majority of vertically integrated pig producers operate on 30,000 – 500,000 hectares of land and grow over 100,000 feeder pigs.

Even without the most recent developments in the agricultural landscape there are deeper economic reasons that may drive pork production up.

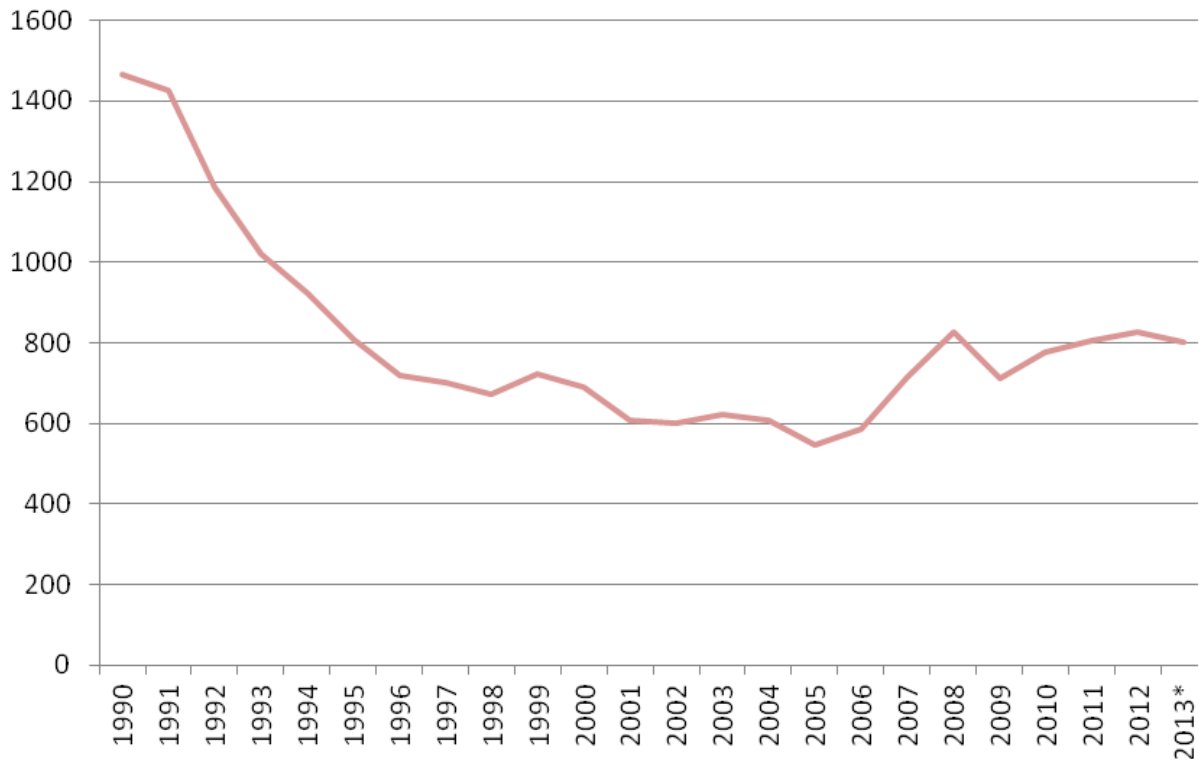
- Pork production facilities in Ukraine will benefit from the cheap inputs**  
 Ukraine is one of the biggest and one of the most efficient producers of coarse grains in the region. At the same time Ukraine is rather a price taker on the world grain market. In a perfect market world the farm gate grain price would be equal to the world market price minus transportation, marketing and other costs. This way a pig farm situated in rural Ukraine would benefit from the cheaper feeds even without interference in the grain market. Other inputs such as electricity, natural gas, water etc. usually cheaper than in EU countries although in many cases Russia has a bigger advantage in energy related ones.

- **Ukraine has one of the lowest labor costs in the region.** Slow economic reforms in the 1990's and 2000's led to a significant GDP drop, low labor efficiency and labor costs. Ukrainian rural areas suffered the biggest impact and labor costs there significantly below national average. According to the World Bank classification Ukraine is a low middle income country with per capita annual Gross National Income (GNI) at \$3,210, fourth from the bottom.
- **Ukraine has relaxed environmental regulations.** Although in place now, this comparative advantage might be short lived. Ukrainian poultry producers who tried to benefit from it soon met strong resistance of local communities. Many new pig farms consider much stricter EU environmental requirements while constructing new facilities. Many see future benefits from bio-energy production and would like to produce high quality organic fertilizers to be used on the fields of their vertically-integrated farms.
- **Ukraine has a significant domestic market for pork.** Being a significant importer of pork (mainly from Germany, Poland and Brazil) Ukrainian pig producers have significant domestic demand they can rely on. Ukrainians traditionally consume significant quantities of pork. Excess demand is satisfied through imports. The recent ban of the Brazilian pork provided domestic producers with an additional incentive for further investments into the industry.
- **Ukraine has a significant inefficient household production of pork.** Almost 55 percent of the Ukraine's swine population (as of April of 2013) is concentrated in the backyard production subsector. Production technologies there are rather primitive with small daily gains and multiple embedded veterinary problems that cannot be resolved in the framework of household production. Industrial production has a significant growth potential on the expense of this big subsector due to cost advantage and better management.

Consumption of pork products (as well as other animal proteins) has exhibited signs of stabilization since the early 2010's. As disposable incomes stabilized after the 2004-07 boom and 2008 economic crisis, Ukrainians consumed close to 800 TMT of pork. Growth of this share is possible at expense of other proteins or due to disposable income growth or expense of total animal protein consumption increase. However, both scenarios look unlikely in the near future.



## Total Domestic Consumption (1000 MT)



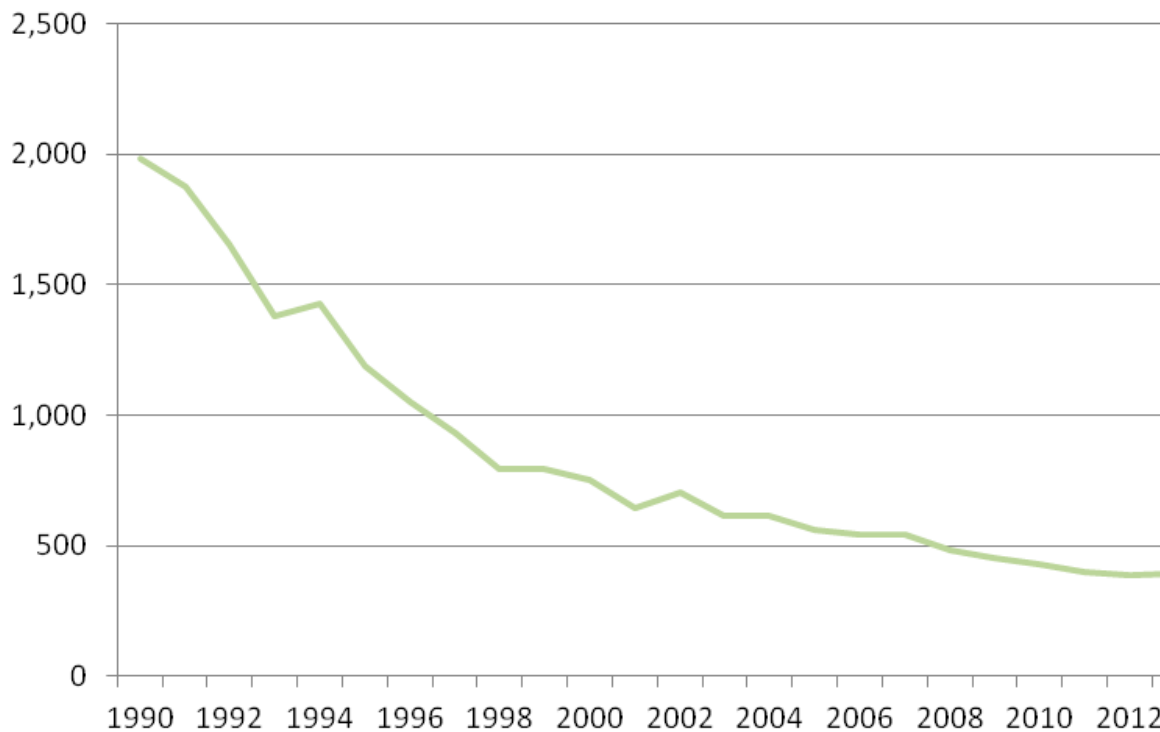
Source: USDA's Official Pork Domestic Consumption.

Current pork consumption and production forecasts suggest that Ukraine will become self sufficient in pork and small regional exporter of this product in the near future. If all investment projects would result in pork excess supply may reach 100 TNT by 2018. Similarly to poultry the long-term export growth will entirely depend on availability of foreign markets.

### **Beef Market: Dropped and Stopped**

The market of beef is the only one without any sign of recovery. Being the most expensive meat, beef has been losing its market share to poultry and pork for the last 20 years. A rebound is unlikely. Milk production (and relatively high milk price observed in recent years) remains to be the only factor supporting the number of bovine animals in the country.

## Beef Production (1000 MT)

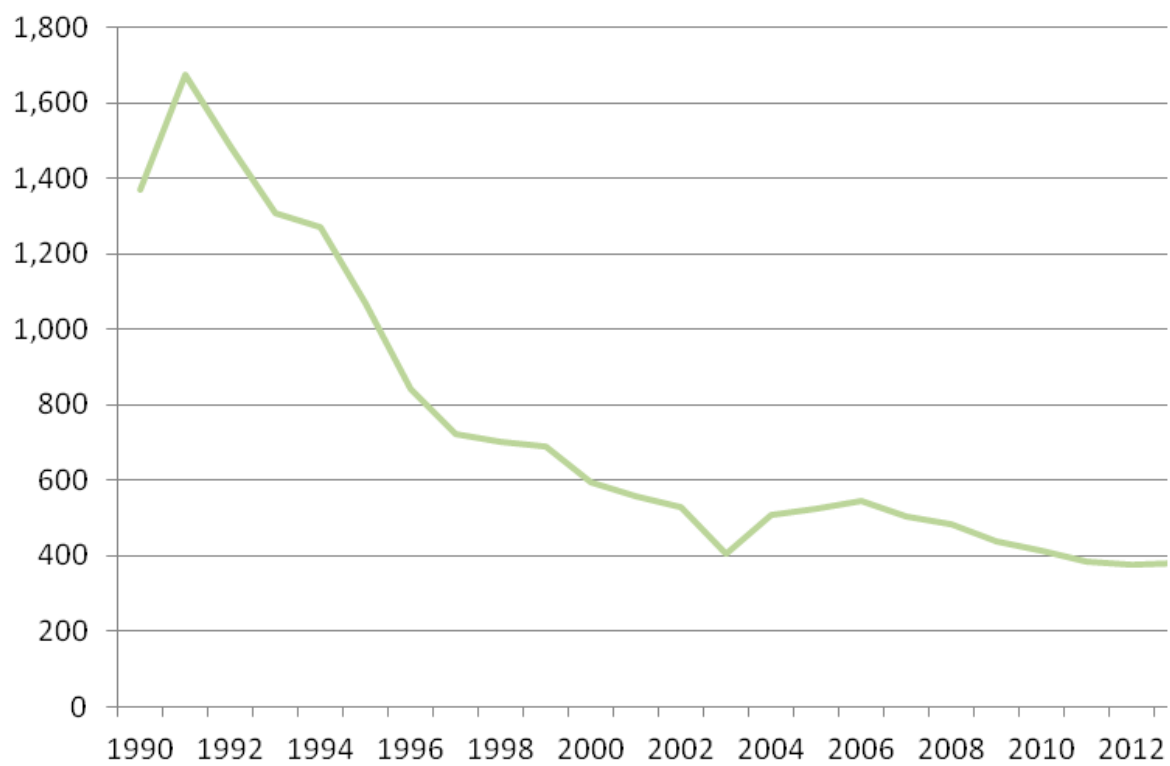


Source: USDA Official data

Small changes in beef production suggest that number of animals in the country have reached some balance and no significant fluctuations are expected in the future. Animal numbers may rebound insignificantly in 2013 in response to high milk price and government support programs aimed at households. Such trend changes will last as long as there is a high milk price or support money in the budget. Consumers in Ukraine continue to be extremely price cautious and return to 1990 consumption pattern is unlikely.

At the same time some consumption increase is plausible. Over time some cattle breeders may shift to beef livestock aiming for affluent consumers as a culture of consumption of high quality beef products gets established in the country. Imports of expensive beef cuts from United States, Australia and Brazil facilitate this culture.

## Total Domestic Consumption (1000 MT)



Source: USDA Official data